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SUBJECT: FRANCE'S "GRAND EMPRUNT": STIMULATING LONG-TERM GROWTH

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¶1. (U) Summary: France is finalizing its second-round stimulus package, which emphasizes investment in research and innovation. President Sarkozy will consult with unions, business and other social partners before final approval in early December, and launch the program in January 2010. The proposed 35 billion euro package (2 percent of GDP) is not expected to impact economic growth immediately but will leverage investment in areas key to France's long-term growth and competitiveness. The broad consultations associated with the "Grand Emprunt" (literally: large debt offering) package are clearly intended to ensure support across the political spectrum for this effort to reorient France's economy. End Summary.

Stimulus Round Two - Investing in the Future

¶2. (U) On November 19, a 22-member blue ribbon commission headed by former Prime Ministers Michel Rocard (PS) and Alain Juppe (UMP) presented their recommendations for allocation of 35 billion euros to off-budget projects that promote innovation and investment in areas critical to the future of the French economy. (French report at http://www.commission-investissement.fr/IMG/pdf/Rapport_191109.pdf) This program is much more targeted than the 28 billion euro first-round package, which provided anticipatory tax refunds to businesses, funded public works projects and gave selective stimulus payments to low-income families (reftel). Linked funding from private sources, matching funds from the European Commission and local government authorities' contributions are expected to effectively bring the scope of the program to some 60 billion euros. Of the 35 billion euros in central government funds, over half (18 billion euros) will target generic innovation, either through university-based research or co-financing for innovative projects of small and medium-sized businesses. The other half targets investments and innovation in specific areas of broad interest including redesigning the cities of tomorrow (co-financing for re-insulating public housing and for innovative urban planning demonstration projects), energy efficiency and renewable energies, transportation of the future, the digital economy and applications of biological sciences. (Details at para 7.) The Rocard-Juppe Commission held hearings and interviewed dozens of experts and economic groups before formulating its

recommendations for the amount and use of funds. President Sarkozy will cap this off, personally, with high-level meetings with business and labor leaders before sanctioning the program in early December.

Impact on the French Economy

13. (SBU) President Sarkozy has justified the investment program not so much by its immediate impact but its potential to put long-term growth back on track. The Economics Ministry estimates that the economic crisis reduced France's non-inflationary growth potential from 2.1% in recent years to 1.7%, due to the drop in investment and the increase in structural unemployment. The initial estimates are that the 35 billion euro innovation and investment program could boost GDP growth 0.5% per year, within five years (based on a simple GDP elasticity calculation). Barclays Capital France chief economist Laurence Boone has similarly predicted that the economic growth impact may not be measurable until 2012 or even 2014.

Growing Public Debt and Deficits a Major Concern

14. (SBU) With the government debt expected to rise to some 85% of GDP in 2010, Economics Minister Christine Lagarde has pushed to structure the program so as to minimize the increase in public debt. At the same time, European Commissioner Joaquin Almunia has said that the 2010 budget deficit must take into account the underlying debt offering in budget estimates. "I believe...that any structure that allows the association of a debt and identifiable assets would be the better project," Lagarde stressed. Others, including Bank of France's deputy governor Jean-Pierre Landau have recommended public-private partnerships in investment projects, and use of

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government-subsidized loans ("prets participatifs") as well as "reimbursable advances" to companies. The government's plans to "recycle" 13 billion euros in government-provided capital recently reimbursed by banks, plus the heavy use of dedicated French Treasury accounts for the package's numerous endowments, will reduce the amount by which the package visibly increases the deficit. Rating agencies have stopped short of projecting that raising another 20 billion euros on the markets will downgrade French sovereign debt, but have said the launch of the program "weakens" France's AAA rating (Moody's) and highlights the need to "clean up" French public finance (Fitch).

GOVERNANCE: KEEPING THE PROGRAM ON TRACK

15. (U) Virtually all the funds will be administered by special-purpose agencies (e.g., government-sponsored financial institutions such as the Caisse des Depots et Consignations and NSF-equivalent Agence National de Recherche), subject to contractual obligations. These agencies will, in turn, establish contractual relationships with public and private entities specifying use of funds, matching requirements, performance requirements and, in some instances, provisions for reimbursement and/or assignment of proceeds. For instance, the National Agency for Campus Excellence in charge of a 10 billion euro endowment will appoint an international panel to select innovative, interdisciplinary projects from five to ten universities that have a potential to raise the institution to international prominence in that area of work. The universities must establish their own dedicated endowment for their project (to which funds from other sources should also be directed) as well as lay out a five-year work program and measurable objectives. To help ensure overall oversight and evaluation of such operations, the Rocard-Juppe commission recommended the establishment of a special body specifically for that purpose, attached to the Prime Minister's office, with representation from the ministries concerned, the parliament and the private sector.

16. (SBU) COMMENT: President Sarkozy launched this project in a first-of-a-kind address to a joint session of Parliament in June and no one doubts that he will see it through. Most of the serious concerns regarding this innovation and investment program relate to

execution and oversight. One economic columnist asserted that application of three key Rocard-Juppe recommendations alone (systematic evaluation, deficit minimization and coordination with other policy reforms) would fulfill Sarkozy's campaign promise of a serious break with the past ("la rupture"). With almost none of the funds being used for government salaries or operations, adequate oversight -- which was sorely missing in similar special programs such as the Balladur debt offering (1993) -- will still be one of the biggest challenges. As for parallel reforms needed to ensure future growth, Barclays Capital's Laurence Boone has highlighted further liberalization of the labor market. Others have pointed to the need for greater university autonomy to encourage more public-private partnership in research. The main questions of direct U.S. interest are the extent to which U.S. businesses may participate in special research and development projects in France, and the extent to which "reimbursable advances" in certain programs risk to become (non-reimbursed) subsidies. End Comment.

Seven Major Priorities, Seventeen Action Areas

¶7. (U) The report submitted to President Sarkozy on November 19 includes seven major priorities, broken down into a total of 17 "action" areas, as follows:

¶I. Support higher education, research and innovation 16.0 billion euros

1 Promote the emergence of 5-10 outstanding institutions of higher learning 10.0 Billion euros

2 Invest in research equipment; make research in France more attractive 2.0 billion euros

¶3. Create a few world-class innovation centers; better leverage

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public research results and support joint public-private research
3.5 billion euros

4 Promote equality of access to higher education and raise the interest in science from an early age
0.5 billion euros

II. promote the development of innovative SMEs 2.0 billion euros

5 Encourage the creation of innovative enterprises and social innovation 0.5 billion euros

6 Facilitate access to financing for innovative SMEs
1.5 billion euros

III. Accelerate the development of the life sciences 2.0 billion euros

7 Support innovation in agro-biotechnologies
1.0 billion euros

8 Boost the search sub-contractor in the health sector and sciences life 1.0 billion euros

IV. Develop the "non-carbon" energies and efficiency in the management of resources 3.5 billion euros

9 Develop non-carbon energy technologies and recycling
1.5 billion euros

10 Create institutes of technological research in the field of non-carbon energy 1.0 billion euros

11 Prepare nuclear technologies of tomorrow
1.0 billion euros

¶V. Promote emergence of the city of the future 4.5 billion euros

12 Foster the development of sustainable cities
2.5 billion euros

13 Accelerate the thermal renovation of social housing
2.0 billion euros

VI. Invent transport/mobility of future
3.0 billion euros

14 Prepare the vehicles of the future
1.0 billion euros

15 Develop the air and space industry of the future
2.0 billion euros

VII. Invest in the digital economy
4.0 billion euros

16 Expedite the transition to super-broadband
2.0 billion euros

17 Expand innovative digital content and applications
2.0 billion euros

Grand Total 35 billion euros

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